

CREDIT OPINION

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New Issue

✓ Rate this Research

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Fort Worth (City of) TX Water & Sew. Ent.

Update to credit analysis

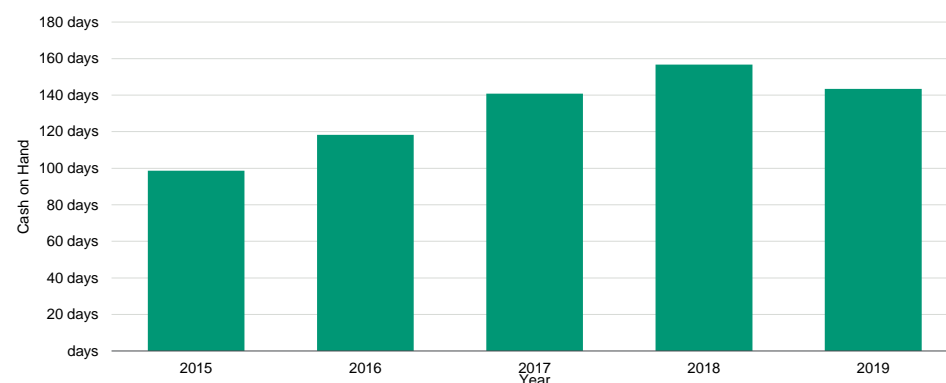
Summary

The city of Fort Worth Water and Sewer Enterprise, TX (Aa1 stable) is a regional treated water and wastewater service provider that benefits from its large and economically vibrant service area in the western Dallas-Fort Worth metroplex. The system exhibits strong management practices including multi-year capital planning and annual rate increases, healthy debt service coverage levels, and a low debt profile. The system's revenue bonds are in part constrained by relatively weak legal provisions and below-median though improved and adequate system liquidity. The system has a manageable level of exposure to the city's unfunded pension liability.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for Fort Worth Water and Sewer Enterprise. Revenues are expected to decline due to a decrease in commercial account demand, though expenditures are also decreasing, leading to stable liquidity. However, the situation surrounding Coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Fort Worth Water and Sewer Enterprise changes, we will update our opinion at that time.

Exhibit 1

Despite decline in FY 2019, liquidity expected to remain stable



Source: Moody's Investors Service, city audited financial reports

Credit strengths

- » Large service area that extends well beyond city limits; growing customer base
- » Strong fiscal management and capital planning

- » Healthy debt service coverage and low direct debt profile

Credit challenges

- » Below median liquidity for the rating category
- » Weak legal provisions

Rating outlook

The stable outlook reflects our expectation the system's strong fiscal management and proactive planning practices will continue in the near term, including implementation of timely rate adjustments to maintain steady debt service coverage and healthy system liquidity amid increasing operating and maintenance expenditures, including rising pension costs allocated to the system.

Factors that could lead to an upgrade

- » Sustained trend of building and maintaining liquidity at high levels
- » Improved legal provisions for the bonds
- » Upgrade of the city's GOLT rating

Factors that could lead to a downgrade

- » A material decline or sustained weak liquidity
- » Weak financial performance leading to a reduction in debt service coverage
- » Significantly increased leverage
- » Rating downgrade of the city's general obligation bonds

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Key indicators

Exhibit 2

Fort Worth (City of) Water & Sewer Enterprise, TX					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	36 years				
System Size - O&M (\$000)	\$248,956				
Service Area Wealth: MFI % of US median	92.60%				
Legal Provisions					
Rate Covenant (x)	1.00x				
Debt Service Reserve Requirement	No explicit DSRF; or funded with speculative grade surety (Baa and Below)				
Management					
Rate Management	Aa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2015	2016	2017	2018	2019
Operating Revenue (\$000)	\$389,205	\$417,299	\$425,615	\$468,171	\$453,437
System Size - O&M (\$000)	\$253,114	\$252,486	\$243,721	\$256,898	\$248,956
Net Revenues (\$000)	\$150,683	\$177,651	\$196,539	\$234,675	\$251,094
Net Funded Debt (\$000)	\$1,062,880	\$753,098	\$791,062	\$804,144	\$823,694
Annual Debt Service (\$000)	\$94,878	\$90,488	\$92,571	\$96,230	\$91,350
Annual Debt Service Coverage (x)	1.6x	2.0x	2.1x	2.4x	2.7x
Cash on Hand	99 days	118 days	141 days	157 days	143 days
Debt to Operating Revenues (x)	2.7x	1.8x	1.9x	1.7x	1.8x

Source: City of Fort Worth's Audited Financial Statements

Profile

Fort Worth is located in Tarrant (Aaa stable), Denton (Aaa Stable), Parker, Johnson and Wise counties. The city's water department provides water and wastewater services to residential, commercial, industrial and wholesale customers. The department serves a growing population of approximately 1.3 million people within the city of Fort Worth and 32 surrounding communities.

Detailed credit considerations

Service and system characteristics: regional water provider with growing customer base

The system's diverse and predominantly residential customer base will remain stable over the near term. The system provides water and wastewater services to residential, commercial and industrial customers within the city of Fort Worth (Aa3 stable), as well as surrounding areas within Tarrant County on a wholesale basis. The system currently has 32 wholesale contracts for water and 23 wholesale contracts for wastewater service. Raw water is obtained from the Tarrant Regional Water District ("TRWD"; Aa1 stable). The system operates five water treatment plants with a total capacity of 500 million gallons per day (MGD), compared to average daily usage of 119.6 MGD in fiscal 2019 and peak usage of 308.4 MGD. The city anticipates expansion of the system will be needed in 2028.

Wastewater from the city and 23 surrounding communities is conveyed and treated at the system's Village Creek Water Reclamation Facility or two wastewater treatment plants operated by the Trinity River Authority. The Village Creek Plant has a permitted treatment capacity of 166 MGD and treated an average flow of 117 MGD in 2019. The city has built into the five year capital improvement plan funding allocation for a new wastewater treatment plant to accommodate growth on the west side of town. This project is anticipated to commence in 2023.

The system's customer base is diverse. The 10 largest water customers accounted for \$9.6 million in annual revenue and 4.3% of total water usage in 2019. The 10 largest wastewater customers accounted for \$7.4 million in revenues and 4.4% of total wastewater usage in 2019. Residential customers accounted for 30.7% of total water sales and 44.2% of wastewater sales in 2019. Wholesale water sold accounted for 38.3% of total water volume in 2019, and 19.7% of wastewater flows.

According to 2018 American Community Survey estimates, the city's wealth levels were near average with median family income equivalent to 92.6% of the US. However, the system's large service area, which extends beyond Fort Worth, is an important consideration and offsets the below average wealth. The enterprise has been continuing to further water conservation efforts while increasing rates to offset decreases in consumption and continue to meet operating and capital needs of the system. Favorably, rates charged by the system to retail customers is affordable relative to peers in the metro area, and the city is able to pass on higher O&M costs to wholesale customers in the broader service area.

Debt service coverage and liquidity: healthy debt service coverage and improved system liquidity

Although there is no rate increase planned for 2021, annual rate increases in the following years are expected to provide steady financial metrics including stable system liquidity. The system has a history of rate increases and a stable trend of increasing revenues to keep pace with growing expenditures. Fiscal 2019 revenues increased 12% from the prior year, which included 3.5% and 3% rate increases to water and sewer, respectively, bringing gross revenues to \$500.1 million. After operating expenditures net of depreciation, net revenues of \$251.1 million resulted in overall debt service coverage of a healthy 2.75 times.

The system utilizes long-term forecasting and revenue assumptions. Year-to-date performance in 2020 (through April) remains favorable relative to the budget – while revenues are projected to be down 3.7%, expenditures are projected to be down 3.8% below budget largely from a credit expected from TRWD. Additionally, the city has waived assessments of late payments from April 1 through June 30th due to the COVID - 19 pandemic. Delinquencies have increased only marginally to 9% up from a benchmark of 5-7%. Net revenues for debt service is projected to be slightly below 2019 results, though maintain healthy debt service coverage. While the city did not need to pass rate increases in 2019, management anticipates future annual rate increases in the near term to offset increasing operating costs and cash-funded capital, and to maintain cash reserves as part of the system's long-term financial plan.

LIQUIDITY

At fiscal year-end 2019, liquidity declined to 143 days of expenses. Per the fund's policy, the minimum reserve level is 62 days and though management expects to maintain unrestricted cash worth at least 150 days of expenses through 2024.

Debt and legal covenants: low debt profile and weak legal provisions

Following the 2020 bond sale, the system will have \$998.8 in outstanding parity debt and an additional \$5 million in outstanding subordinate lien bonds. Payout is average with 55.5% of principal retired over the next 10 years. The system's debt to revenues ratio at 1.8 times in fiscal 2019 is at the median for the rating category. The five year CIP plan calls for just under \$800 million in investment into the system, approximately 63% of which is planned to be debt funded and the remaining 37% will be cash funded. Despite the plans for additional borrowing, we expect the system's debt profile relative to revenues will remain below 2 times given the relatively above average pace of principal retirement and ongoing rate increases expected.

LEGAL PROVISIONS

Legal provisions for the bonds are weaker than traditionally seen among utility revenue bonds, though adequate given the strong management of the system. The city has covenanted to fix, establish, maintain and collect such rates, charges and fees for the use and availability of the system at all times as are necessary to produce gross revenues and other pledged revenues sufficient (1) to pay all current operating expenses, (2) to produce net revenues for each fiscal year at least equal to the annual debt service requirements. The additional bonds test states that net revenues for the preceding fiscal year, or for twelve consecutive months out of the fifteen months immediately preceding, must be at least equal to 1.25 times average annual debt service and 1.1 times maximum annual debt service. There is not a debt service reserve established for the bonds, though improving system liquidity is considered healthy and adequate.

DEBT-RELATED DERIVATIVES

The system does not have any variable rate debt and is not a party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

The system contributes to a single-employer defined benefit pension plan (the "city plan") administered by the Employees' Retirement Fund of the City of Fort Worth for employees of the system. In fiscal 2019, the system contributed \$13.2 million to the City Plan, which accounts for 13.5% of the city's total contribution of \$98.1 million to the plan and 2.6% of the system's 2019 operating revenues. The system's 13.5% share of the total adjusted net pension liability (ANPL) of the city plan equates to \$480 million as of fiscal 2019, or 1 times revenues. In December 2018 the city council approved pension reform, which included benefit reductions and increases

to city contributions; employees approved increases to their contributions in February 2019. Implementation of the reform occurred in July 2019. The city's contribution to the plan is projected to continue to fall below the actuarially defined contribution rate, as well as our calculated "tread water" level, which measures the annual government contribution required to prevent the reported net pension liability from growing under reported assumptions. The city has incorporated increases to pension contributions in the five year financial forecast for the utility system, and corresponding rate increases needed, which range from a manageable 2.9% to 5.5% annually from 2020 through 2024. There was no rate increase in fiscal 2019.

Environmental, social, and governance considerations

ENVIRONMENTAL

The city is within the Great Plains region, which is forecast to be most affected by rising temperatures that put increasing strain on water supplies and energy. The region is also expected to see periods of extreme rainfall that can cause flooding. The city maintains a robust water, wastewater and stormwater capital improvement and conservation plans to manage these risks, which are expected to materialize over the long term. The city purchases raw water from the Tarrant Regional Water District, which continually invests in sourcing new water supply to manage regional growth and water demand.

SOCIAL

Demographic and socioeconomic trends in the city are favorable. Since 2016, the city's population has increased 5.2% as strong job growth through February 2020 was fueling in-migration. The median family income in the city as of 2018 was slightly below average, but favorable for a large urban center at 92.6% of the national median. Median age in the city is also relatively young, at 32.5 years, compared to a national median of 37.9 as of 2018.

GOVERNANCE

The system exhibits strong fiscal management, demonstrated by appropriate and timely rate setting measures, prudent and conservative budgeting and forecasting of revenues, as well as maintenance of multiyear planning. In addition to the liquidity goal, the system has a goal to maintain a minimum level of working capital in the enterprise funds equal to three months of regular, on-going operating expenses (including transfers out). The system also has a goal of a minimum level of working capital in enterprise funds equal to three months of the amount being paid in debt service payments for the subsequent fiscal year. Rate adjustments must be approved by city council.

The system's water department consists of three separate functions: water, wastewater and reclaimed water, each of which have several divisions responsible for specific areas. The water department is responsible for providing safe, clean drinking water to city residents and customer cities. The wastewater department collects, monitors, treats and processes domestic and industrial waterborne waste from the city and other contracting communities. The reclaimed water department provides highly treated effluent from the city's water reclamation facility to wholesale and retail reclaimed water customers for nonpotable uses such as irrigation and industrial water cooling towers.

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